

MEMORANDUM

TO: Robert Macy

FROM: William R. Harris

SUBJECT: Intelligence Markets for Missourian Skeptics

That you are a "Man from Missouri" is one of the features of your judgment which commended you to the Murphy Commission. On the one hand it is essential that the Commissioners be presented with summary analyzes of any fundamental conceptual/institutional reforms of practical significance; on the other hand, it is essential that the practical difficulties of implementation be addressed, so that the Commissioners may, in their own judgment, probe identified issues or dismiss them as they choose.

That the U.S. intelligence community could quickly transform itself from an administratively regulated system to a quasi-market system (nonetheless constrained by consumer and producer-agency budget appropriations ceilings) is a proposition which is not, I believe, accepted by experienced observers of the intelligence scene. The mere impracticability of immediate transformation should not obscure consideration of two issues:

1. Is a quasi-market system, in which intelligence producers both generate new market demand and respond to consumer purchases, preferable as a normative standard to the present system of administering the production of intelligence as a free consumer good?
2. If a quasi-market system is preferable in normative terms, what institutional reforms are practicable so as to develop and evaluate experimental intelligence markets (in circumscribed sectors of intelligence production)?

I propose for your consideration the following modules, which might be incorporated in a program for the reform of foreign intelligence resource allocation practices:

- A. Consumer market sampling (experimental):

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For a designated period of time, all production of intelligence from a particular USIB agency office would be directed by consumers, in accordance with prior allocation of man-days (person-days) among consuming agencies. Specific line items could be exempted, so as to continue particular product lines during the trial period.

B. Experimental product design group

For a designated period of time, a new products design group would be funded at a designated level. "Seed capital" could be invested within USIB or the sponsoring agency for the production of new product lines. Those product lines which were "bought" by consumer agencies, from experimental intelligence monies, would thereafter be removed from "seed capital" financing. Competing design groups could compete for funding takeovers in the N+1st fiscal year.

C. Product cost education program

Sorels-type studies\* of all major product lines would be undertaken on periodic basis. Such studies would, in seriatim, approximate inputs to various product lines. In aggregate, however, Sorels-type evaluations should permit approximation of dollar costs of the various product-lines of estimates, bulletins, and specific intelligence "requirements." With such information consumers might amend the mix of requests, and IRAC might alter its new system investment strategy.

D. Consumer Allocation of New System Capital Costs and Depreciation Charges

Subsequent to system-wide cost disaggregation (aided by Sorels-type post mortems), projections of new product-lines (or the incremental system share of jointly-produced outputs) would be overlaid with projections of proposed new capital expenditures (less savings from phasing out of obsolete intelligence systems). Identified consumers would be required to include appropriate components of fixed capital costs in consumer agency

Note: \*After the OMB prototype  
of Charles A. Sorels

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budgets for appropriate fiscal years. In such manner, the costs of "requiring" intelligence products which induce major capital investments would be recognized before new systems were committed. If rates of depreciation were identified, for inclusion in future fiscal year budgets, the future costs of present decisions would be more readily understood. Economists may disagree over specific approaches, but are able to allocate joint supply and joint product costs.

E. Probabilistic Scoring Systems by Production Unit and Product Line

Dr. Thomas Brown, et al (RAND) have modified U.S. Weather Bureau techniques for the scoring of forecaster "track records" and capabilities to cope with uncertain information. Dr. Clinton Kelly, et al (Decisions and Designs, Inc.) have developed other relevant probabilistic scoring techniques. If intelligence managers or intelligence consumers are to be permitted a fair choice in their investments, they deserve access to a product-line which is not so hedged as to preclude statistical scoring, and they deserve access to past track records in their consideration of future investments. Without greater fairness to consumers, in disclosing to them track records of prior performance, it is likely that consumer choices will be skewed by their illusions of product reliability/unreliability. In the early 1970's admissible scoring techniques are being resisted by intelligence producers. Were producers to compete for consumer dollars (picking up new product-lines), the more reliable ones might well "score" their track records, and the others might not be far behind.

The question is not whether a market for "intelligence product" futures - a Chicago Board of Trade - should be an exclusive mechanism, or even a central mechanism in the provision of outstanding intelligence support. The question is whether the market model is a preferable norm, to that of the present, and if so, whether there are practical steps which can be taken to breathe initiative and responsiveness into the production system. In the final analysis we are looking for outliers on the curve, for those rare and prescient analyses which cannot be mandated. If an infusion of market competition challenges intelligence analysts and managers alike to anticipate issues, and to innovate in product marketing, intelligence production may blossom with the creativity which is widely sought.


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Since the inception of modern intelligence production in the United States - roughly the last 35 years - there has emerged an undeviating stream of commentaries suggesting a widely-perceived but little-understood mismatch of intelligence producer and consumer interests. Kent (1949) formulated an isolationist doctrine for sensitive intelligence producers, based upon the World War II OSS experience. Hilsman, first as a bemused scholar (1956), later as a production manager (1966) noted the stability of marketing mismatches. Recent documentation of mismatches may be found in the NSCIC/Working Group post mortem on the Indo-Pak crisis of 1971, and a series of memoranda from the NSC intelligence staff to the DCI (1972-1974).

It is not claimed that the tension between prediction and decision is amendable to satisfactory resolution. Rather, it is claimed that no administrative organ - be it IRAC, or the DCI and his office, backed by IRAC and the IC staff - can differentiate the complex and shifting nature of intelligence markets without a significant element of market choice. Market choice and market competition from potential producers outside USIB have been minimized, if not systematically impeded, over the last decades. Intelligence markets are in rapid transition, during a post cold-war, resource-scarce, competitive international transformation. If consumer preferences are likely to change faster than most producers would now anticipate, would not enlargement of the intelligence marketplace be a practical necessity, and not necessarily impractical?

  
William R. Harris

STATINTL

July 31, 1974

MEMORANDUM TO: Robert Macy

FROM: William R. Harris

SUBJECT: Institutional Mechanisms for Efficient Regulation of Intelligence Markets

I. Introduction.

On July 17, 1974, the Commission on the Organization of the Government for the Conduct of Foreign Policy authorized commencement of an intelligence research program, including a paper on "Intelligence Resource Management" to be undertaken by you. This memorandum sets forth one analytic framework for your consideration. In no sense is the framework intended to constrain or limit your own analysis, which should encompass efficiency in resource expenditure and utilization of the resource management process to clarify and support governmental objectives.

II. Observations on Dysfunctional Aspects of Intelligence Markets.

Intelligence institutions are governmentally-licensed, publicly owned entities, hereafter termed informational public utilities (IPU's). Service territories and informational commodities are strictly regulated, hence competition is restricted or eliminated. In some respects IPU's are natural monopolies - purveying informational commodities most efficiently managed by a single firm - and in other respects they are artificially oligopolists whose markets are protected by restrictive practices, viz, security bars to acquisition of relevant information by competitors, prohibition by intelligence directive of direct competition, and "dumping" of informational commodities at prices far below marginal costs (often at zero price).

One pattern of the informational public utility marketplace may be identified as central to many of the widely perceived dysfunctions about which intelligence consumers complain: anticompetitive IPU regulation, the central feature of which is the passive acceptance by OMB and the Congress of a system of financing which permits the "dumping" of subsidized intelligence products within the captured service territory at a price of zero, or nearly so.

When the commodities of an informational public utility are provided without cost, or at highly subsidized prices (including administrative and security costs) the following distorting market effects are likely to occur:

- Demand for the commodity is likely to exceed the supply.
- By averting purchasing decisions, consumers are unlikely to appreciate their own utility functions, and product discrepancies respecting commodities offered.
- Consumers may be substantially indifferent to alternative commodity product costs (both unseen and unpaid), thereby overexercising and overextending high-cost collection systems.
- Free commodities with marginal costs in excess of value-of-service will be perpetuated rather than eliminated.
- Rationing of commodity production (under conditions of excess demand) will be appropriated to regulatory organs likely to be "captured" by the informational public utilities which they regulate.
- Elaborate production rationing systems will be subject to "regulatory lag" - so that a general insensitivity to consumer preferences (and variations in consumer preferences) will be exacerbated by consumer preference shifts.
- Without peak-load pricing, informational public utilities will be vulnerable to "brownouts" and "blackouts" in crisis, and will be unresponsive to fast-shifting consumer preferences in crisis.
- Competition by firms outside the protected regulatory sector - e.g. universities, newspapers, research contractors of intelligence bureaus and other governmental departments, and forecasting services of other agencies - will be minimized by discriminatory and exclusionary practices of cartel-member (USIB) agencies.

### III. Issues of Institutional Reform.

Interagency and interdepartmental recoupment has recently been the subject of an OMB/CIEP study for other than intelligence agencies. There is no a priori reason not to consider the incorporation, where practicable, of market and recoupment mechanisms in the regulation of supply and demand for intelligence products.

The following may be among the alternatives for consideration:

A. Consumer-agency contract purchases:

- (1) Reservation of a portion of the DoD-appropriated monies for transfer to CIA, to the Office of the Secretary of Defense and JCS, for allocation by those offices in the procurement of intelligence products within DoD, from CIA, or elsewhere.
- (2) Appropriation to other agencies of intelligence production monies for interagency or exogenous intelligence procurement.
- (3) Appropriation to CIA of monies for agency-initiated products, under a budget ceiling, such that, if product lines are not "picked up" in subsequent fiscal year by consumers, such product lines must be either funded from ceiling funds or discontinued.

B. Annual submission by consumer agencies of requests for intelligence product-line coverage to OMB for utilization in IRAC and OMB review of Combined Intelligence Budget and five year DCI resource plan.

William R. Harris

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TO: [ ]

☐ YOU WERE CALLED BY— ☐ YOU WERE VISITED BY—

OF (Organization)

☐ PLEASE CALL → PHONE NO. CODE/EXT.   
☐ WILL CALL AGAIN ☐ IS WAITING TO SEE YOU   
☐ RETURNED YOUR CALL ☐ WISHES AN APPOINTMENT

MESSAGE

[ ] the Director's secretary called to say that Mr. Colby will be up on the hill this afternoon. She has moved Mr. Macy's appointment back to 3:30. I called [ ] office to see if he could move his meeting back or keep him longer. He can't do either. I called Mr. Macy and explained the situation to him and he said that it was all right with him.

RECEIVED BY	DATE	TIME 11:25
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